Constitutional and Supranational Review on Tax Legislation Across the Mediterranean

Constitutional and Supranational Limitations and Guidelines on Taxing Powers: The Case of Croatia

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ABSTRACT

The paper deals with Constitutional and supranational limitations and guidelines on taxing powers in the Republic of Croatia. Constitutional limitations and guidelines that directly determine the design of tax system are scarce and confined to equity and equality principles. However, the other, more general provisions give grounds for the Constitutional Court to decide on tax matters more freely. In the context of the Croatian tax system, the role of the opinions of the Ministry of Finance was examined. Other limitations and guidelines can be found in international agreements Croatia applies. Stabilisation and Association Agreement, a pre-accession agreement concluded with the EU, regulates some fiscal matters, prohibiting and limiting discrimination in that field. Theoretically, it can be directly applied, while EU law can be used as interpretation tool even before Croatia becomes EU Member State. However, because of prevailing legal culture, hardly it could be expected that the Croatian courts will apply European law, or use it as a means of interpretation, before the accession process will be finished. Another set of supranational rules, double taxation conventions, also contains provisions that are by their legal force above Croatian domestic law; however, due to the general concept of Croatian tax system when it comes to international aspects, there has been no collision of the treaty provisions and domestic norms so far.
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1. INTRODUCTION

When discussing the constitutional and supranational provisions concerning taxation, in the case of the Republic of Croatia two layers of norms can be recognized; they are indeed the ones mentioned as the very topic of this workshop. So, both the constitutional and supranational issues that refer to taxation should be discussed.

In the second part of the paper (first one being the Introduction), the provisions of the Croatian Constitution will be the object of analysis. When it comes to the Constitutional provisions dealing directly with the tax issues, they are scarce and short, focused on equity and equality when regulating payment of the tax. However, there are some other provisions that give more elaborate ground in tax matters as well.

Third part is devoted to the decisions of the Constitutional Court. There have been only a few such decisions in tax matters, and a number of cases is still pending. However, general direction of the Court's reasoning can be seen from the two decisions that will be analyzed.

Opinions of the Ministry of Finance, as a means of Tax Administration to circumvent the slow and complicated procedure of changing and amending tax statutes, in order to ease the everyday operation of tax system, will be analyzed in the next part. Those opinions create an informal source of law, diminish the legal certainty, and call for legal action to prevent such practice.

One could ask – what constitutes the supranational layer when it comes to Croatia, especially considering the European context? Croatia is, namely, still not the part of the supranational association that would have got the authority to implement some supranational tax rules, i.e. the European Union (hereinafter: EU). However, Croatia is presently the candidate state, investing efforts and time to join the EU. One of legal documents that pave the way for the full membership, and the one Croatia signed and is applying, is the Stability and Association Agreement (hereinafter: SAA). The SAA lays down some legal and political obligations that have to be fulfilled by applicant state, if it is to become the EU member state. The SAA regulates many different issues, and, amongst others, some tax ones; they shall be analyzed in the fifth part of this paper.
Legal consequences of the possible direct and interpretative effect of the SAA and EU law are considered in the sixth part. There are different opinions on the subject even in the legal writings of the scholars in the EU Member States; however, in Croatia, at the moment at least, euro-optimism prevails, and (rare) authors argue, in favour of direct effect and interpretative role of the SAA and the EU law in Croatian legal order.

In the seventh part, the role of the Croatian tax treaty network is briefly considered. Those international agreements prevail over domestic tax legislation; so far, thanks to relatively simple Croatian tax provisions when it comes to international aspects, there have been no colliding issues.

2. CONSTITUTIONAL PROVISIONS

According to the well-established continental tradition, Croatia has got the written constitution.\(^1\) Furthermore, while Croatia was the part of the former SFRY\(^2\), as one of its federal states (under the name "Socialist Republic of Croatia", hereinafter: SRC), it also had the written constitution. Those constitutions are, however, quite different legal documents – previous one, dating to the time of the former SFRY, was a lengthy document, tending to regulate in detail all the conceivable aspects of the socio-political and economic life in the SRC. Probably being reaction to such an approach, the Constitution of the Republic of Croatia is much shorter; one possible consequence, stemming from its shortness, is that it is rather scarce when it comes to regulation of some issues.

One of such scarcely regulated issues is the issue of taxation. Only one (short) article, namely, refers to public expenses and tax system; it is Article 51, and it reads: (Para. 1) "Everyone is obliged to participate in the settlement of the public needs, according to his economic capacity"; (Para. 2) "Tax system is based on the principles of equality and equity". It is easy to recognize some principles of taxation, well known from the work of Adam Smith (and from the work of some other experts and theoreticians following him, too), specifically the principles of considering taxpayer's economic circumstances (ability to pay), of equal position

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\(^1\) The consolidated text of the Constitution is published in "Narodne novine" (the Official Gazette), No. 41/01 of May 7, 2001 together with its corrections published in "Narodne novine" No. 55 of June 15, 2001.

\(^2\) “SFRY” is an acronym of the full name of the former state, and stands for "Socialist Federative Republic of Yugoslavia".
of the taxpayers, and of equity. In fact, the social dimension of the taxation is given not only predominant, but the only constitutional value. This is in accordance with the very basic Constitutional proviso (Article 1), stating: "The Republic of Croatia is a unitary and indivisible democratic and social state" (bold – H. A.). All the other numerous conceivable tax considerations are non-existent in the Constitution in the only article referring directly to the systems of financing public needs and of taxation. Such approach, on the one hand, confers the message of the overall importance of social sensitivity as a key rationale of the Constitution against the tax matters. However, on the other hand, that message stops right where it begins. The implied conception was not nearly so worked out thoroughly, so that the said scarceness of the norm raised the objection that such approach does not even determine the type of tax rates the income should be taxed at. Bearing, namely, in mind the Constitutional focus on social issue, both at the highly general level (Article 1), and in the tax specific Article 51, one would might expect that the Constitution will make that one final step and stipulate progressive tax rates for the income of individuals, as the ones aiming, by some definitions, at achieving equity as one of the key Constitutional goal. On the other hand, it could be replied that it is not the task of the Constitution to determine and even design tax policy in that way; rather, it should be left to the legislative. Be that as it may, the Constitution refrained from stipulating the type of tax rates, leaving, that way, free space to legislator, and raising never ending theoretical disputes.

It is obvious that social sensitivity plays very important role as a principle in the Croatian Constitution, and, therefore, as one of the key sources of the Croatian Constitutional order. In the field of taxation, however, things are never simple, especially when tax equity is at stake. For example, dividends in Croatia, paid to the shareholders within Croatia, inbound or outbound, presently are exempt.\(^3\) That raised some disputes on the equity grounds; arguments were not new, they are well known to the community of tax experts, be they scholars or practitioners. The tax policy was, whenever the taxation of dividends (and not only them!) was the issue, throughout the short history of Croatia as a sovereign state, far from determined; rather, it changed the course with every Government change, which means that it went through three such changes so far, from non-taxation, then taxation, and non-taxation of dividends again. While serving the needs of daily politics, such uncertainty surely was sending a discouraging message to every serious investor, domestic or foreign. It also shows

\(^3\) Income Tax Act, "Narodne novine" No. 177/04, Art. 9; Profit Tax Act, "Narodne novine" No. 177/04, Art. 31.
uncertainty in comprehension of the notion of tax equity, as well as in its practical application, since in Croatia, one could easily conclude, it depends on the current governing structure.

Leaving those theoretical taxation disputes aside, there are some other provisions that regulate some basic issues, which can be construed as the constitutional limitations of the taxing powers of the Croatian parliament and of other levels of government as well. Those could be found in the articles regulating basic economic rights.

For example, in the third part of the Constitution, entitled "Protection Of Human Rights And Fundamental Freedoms", Article 16 stipulates the possibility of limiting freedoms and rights:

"Freedoms and rights may only be restricted by law in order to protect freedoms and rights of others, public order, public morality and health.

Every restriction of freedoms or rights shall be proportional to the nature of the necessity for restriction in each individual case."

As a standard constitutional provision, that could be found, in a more or less similar wording, in most today's constitutions, it provides a broad base for protecting, inter alia, taxpayers' rights and, exactly because of its broadness, could prove to be one of key constitutional instruments that limit the taxing powers of the modern state.

Article 48, Para. 1 contains the guarantee of the right of ownership. That norm can be construed as the one that excludes harsh taxation measures, aimed at dispossessing individuals of their property by means of taxation. Although it is hard to imagine the tax policy that would result in a total breach of such a basic right present in every democratic country based on the rule of law, exactly that Article, as could be seen infra, was used by the Constitutional Court as an argument supporting one of the Court's decisions in tax matters. It should be mentioned that Para. 2 of the Article 48 contains the limitation of the right of ownership, providing that "(O)wnership implies obligations. Owners and users of property shall contribute to the general welfare."; this provision works the other way around, potentially delimiting tax authorities when they design tax policy.

Provisions contained in the Article 49 regulate some other basic economic rights and freedoms:
(1) Entrepreneurial and market freedom shall be the basis of the economic system of the Republic of Croatia.

(2) The State shall ensure all entrepreneurs an equal legal status on the market. Abuse of monopoly position defined by law shall be forbidden.

(3) The State shall stimulate the economic progress and social welfare and shall care for the economic development of all its regions.

(4) The rights acquired through the investment of capital shall not be diminished by law, or by any other legal act.

(5) Foreign investors shall be guaranteed free transfer and repatriation of profits and the capital invested.

Although provisions of the Article do not refer directly to taxation, most of them could also be construed as Constitutional tax policy limitations; furthermore, it is highly likely that this will happen, and not in some distant future. There are some possible interpretations:

1. Para. 1 could be read as the prohibition of the tax measures that would harm the freedoms mentioned, i.e. as the prohibition of the excessive taxation of entrepreneurship, with consequence of hindering it. This interpretation is only a hint of an age-long tax dispute that will also be mentioned infra, when analyzing Para. 3.

2. The first sentence of Para. 2 can easily be interpreted so that no discriminative taxation, e.g. privileging ones and disadvantaging the others, is allowed. When it comes to taxation, this is in fact the request for tax neutrality; state action, taking form of taxation, must not produce market winners and losers.

3. Broadly defined state's obligation to take care of economic progress and social welfare of the country as a whole in the Para 3 could by all means be used in tax context. It could be used by tax delimiters, as well as by the tax expanders, because the Constitutional norm uses the phrases "economic progress" and "social welfare", and in the same sentence. Those values could sometimes oppose each other. In the field of taxation, the voice of social sensitivity could ask for heavier taxation, trying to achieve higher degree of social justice through, firstly, redistribution of the part of the wealth of individuals, and, secondly, through better funding of social needs. On the other hand, however, adversaries could argue that higher taxation would hinder economic activity, hindering, that way and at the same time, economic...
growth as well. Discussion on what spurs and what hinders economic growth is an old one, and its participants find some of their perhaps best arguments exactly in the field of taxation.

4. Constitutional norm contained in Para 4 prohibits any legislative action from being taken, that would harm the rights acquired through investments. The taxation is by definition implied in this norm, furthermore, it could be construed that it is high on the list as a potentially efficient instrument harmful for the said rights. The changing regime of the taxation and non-taxation of the dividends generally (and outbound dividends as well), which occurred in Croatia in the last fourteen years, could be a good example of that harmful potential of taxation regarding foreign investments. Also within scope of this provision, tax incentives limited by time (tax holidays), once acquired, cannot be abolished by any kind of legal act before the time they are approved for elapses.

5. Analyzed provisions serve not only as the means of achieving legal certainty, i.e. one aspect of the rule of law, but also as the measure of attracting foreign investments; Para. 5 should be interpreted in the same sense. Although having broader (than only tax) meaning, this norm guarantees foreign investors shall not be taxed in the way that would hinder them from exporting capital invested, and the proceeds gained.

3. CONSTITUTIONAL COURT'S DECISIONS: SOLVING TAX ISSUES

Most of these interpretations of the Constitutional norms in a tax context, however, are, for the time being, only hypothetical. They could gain the real legal strength only through the Constitutional Court's rulings, which would, through the relevant case law, draw borders to legislative powers in the tax matters. During its existence, dating, in Croatia as an independent state, since 1991, that Court ruled in the tax matters only on a few occasions. However, two of its decisions could be construed as having rather far-reaching ramifications, resulting, for example, in abolishing several taxes (it should be mentioned, though, of a local significance), and, perhaps more important, establishing some interpretations of tax matters that bear considerable future importance.
3.1. REAL ESTATE TRANSFER TAX

Facts: Mr. Dalibor Ilic initiated the proceeding at the Constitutional Court, claiming that one provision of the Real Estate Transfer Tax Act is contrary to the Constitution of the Republic of Croatia; the challenged provision stipulated the 20% increase of the amount of the real estate transfer tax, provided the tax obligation is not reported on time; the taxpayer (the person alienating the real estate) is obliged to report the real estate transfer within 15 days from the day that transfer has become legally binding. The tax increase for the deadline missing was set, as mentioned, at 20%, but not less than 1.000,00 Kuna. Mr. Ilic submitted that such increase was not in accordance with Article 3 of the Constitution, stipulating, inter alia, that "(F)reedom, equal rights, social justice and the rule of law are the highest values of the constitutional order of the Republic of Croatia and the ground for interpretation of the Constitution", and with aforementioned Article 51.

Constitutional Court's Decision: The Court held that the Constitutional suite is justified, abolished the challenged provision, and initiated the process of assessment of the challenged Article with the Constitution, arguing 1. that the 20% increase means in fact punitive taxation, which contradicts the goal and the sense of taxation, and is therefore contrary to Constitutional principles contained in Article 51 of the Constitution; 2. that Real Estate Tax Act stipulates the application of the Income Tax Act. At that time, the Income Tax Act contained the provisions stipulating the fines for the tax misdemeanours, missing the deadline for the submission of the tax return being one of them. The amount of fine was set between 1.000,00 and 10.000,00 Kuna. The Court held that this provision, combined with the challenged one, leads to the unequal treatment of taxpayers, favouring the ones with higher real estate transfer tax base. Since, namely, the tax increase was set at 20%, but in any case not less than 1.000,00 Kuna, the taxpayers with lower real estate transfer tax base could end up paying even more than 20% (because, in their case, the established 1.000,00 kuna minimum fine could be more than 20%), while the taxpayers with higher real estate transfer tax base will always pay exactly 20%.

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4 Kuna is Croatian currency; 1 euro is, at present, cca 7,4 Kuna.
5 Constitutional Court's Decision, "Narodne novine" No. 26, 3 March 2000 ("Narodne novine" is the name of the official gazette of the Republic of Croatia).
3.2. TAX ON Idle AGRICULTURAL LAND, TAX ON UNUSED ENTREPRENEURIAL REAL ESTATE, TAX ON UNDEVELOPED BUILDING LAND

Facts: Mr. Ivan Simunovic and Mr. Bozidar Jelcic, acting independently, lodged Constitutional suits, claiming that the aforementioned taxes are contrary to Articles 3, 48 and 51 of the Constitution.

It should be mentioned that those taxes were introduced into Croatian tax system in June 2001. They were two-purposed: 1. their first purpose, and the more important one, was non-fiscal; they should have "punished", by way of taxation, the persons owning but not using the real estates in question and at the same time they should have encouraged them to bring those real estates to use according to their nature; 2. the second purpose was that they, as municipal taxes, should have served as a source for financing the needs of the municipalities (which, in most cases, in Croatia suffer from the chronic lack of financial resources).

In their suites, the claimants submitted that taxes in question do not regard the ability to pay (economic strength) of the taxpayers; they breach the equity principle as one of the key principles of taxation. The fact relevant for the property taxation is the property ownership, and not the way the property is being used, so the taxation of the real estate should extend to all owners of the certain type of the property, and not only to those who do not use it in the manner the legislator thinks it should be used. Those taxes, therefore, are contrary to economic and socio-political principles a tax system should be based on. They are punitive taxes, because their purpose is to coerce property owners to certain behavior which is neither constitutionally nor legally based.

Constitutional Court's Decision: The Court held those Constitutional suits justified, too, abolished the challenged provisions, and initiated the process of assessment of the challenged Articles with the Constitution. The Court founded its reasoning on the Articles 16, 48 and 51 of the Constitution. The Court, having regard to the importance of the right of ownership, concluded that the owner of the entrepreneurial real estate, undeveloped building land and idle agricultural land cannot be forced to use his property in a certain way, if this usage cannot be ascertain as a contribution to public welfare, respectively, if it does not serve

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to protect interests and security of the state, nature, environment and human health. Challenged taxes impose indirectly the obligation to the use of the real estates to their owners. Since this limitation is not established to accomplish Constitutionally allowed goal, nor it is appropriate to the nature of the limitation, the Court held that it unjustifiably limits Constitutionally guaranteed right of ownership and, as such, by itself, breaches that right. Those taxes, argued the Court, are in fact punitive taxes, punishing the owner (which is at the same time the taxpayer) for not using his/her real estate; however, held the Court, is contrary to the ownership limitations allowed by the Article 16 and Article 48 Para. 2 of the Constitution. Implied real estates obligation usage is contrary to the legitimate expectations of the owners, regarding the principle of the legal certainty of the effects of legal order\(^7\), since challenged articles do not define, in sufficient manner, what exactly (which kind of behaviour or practice) would exempt owner from the tax; to put it shortly, the principle of the legal certainty is at issue in this case, too.

Furthermore, introduction of the aforementioned taxes is contrary to the Article 51 of the Constitution. First of all, those taxes are contrary to the principle according to which everyone is obliged to participate in the settlement of the public needs according to his economic capacity, because, neither when defining taxpayers, nor when stipulating the tax rate, had the economic capacity been taken into consideration. The key taxable circumstances were the facts of idle agricultural land, non-use of entrepreneurial real estates and non-development of the building land; the economic capacity of the taxpayer had little, if anything, to do with the definition of the tax liability. Tax relief, stipulated for the idle agricultural land tax, was insignificant. Further, those taxes were contrary to Constitutional principle of equality and equity of the tax system, because taxpayers are only selected categories of the real estate owners, and not all of them, and the criterion differentiating taxpayers from those that do not pay those taxes did not fit into Constitutional principles. The Court went on arguing that it should be concluded that, in the context of the nature of the right of ownership and limitations thereof, decisive taxable facts have to be the very existence of the real estate and ownership thereon, and not the way it has been used. Equality, as the constitutional foundation of the tax system, is missing if the tax is the form of punishment, aimed at coercing owners to use real estate contrary to their interests or possibilities. Because of all that, the said taxes were not in line with the principle of equity of the tax system, demanding that the tax burden should be

\(^7\) Principle expressed in an earlier Court's decision (Decision No. 26, November 23, 2005, "Narodne novine").
borne proportionally by all taxpayers of the specific tax, bearing in mind, at the first place, their economic capacity.

4. AVOIDING PROCEDURE: TAX ADMINISTRATION FIGHTING CONSTITUTIONAL AND LEGISLATIVE LIMITATIONS

Analyzed cases give by far too little material to any definitive conclusion on the place and role of the Constitutional Court concerning Croatian tax system; hence the question in the title of this part. However, hypothesis would be that its influence on that system, obtained through growing numbers of cases decided, would grow steadily. One indicator of such development is, e.g., the number of pending cases; there are at least five of them\(^8\), waiting to be decided. They all concern two features of the income tax, i.e., the taxation of pensions and of dividends.

Deciding in those cases in favor of the taxpayers-claimants, the Court established itself, by way of its rulings, as an efficient instrument of Constitutional control over the executive branch in the matters of taxation. By way of its decisions, it expressed the will to cut deeper into the taxation issues, and to rely not only on (scarce and somewhat unclear) Article 51, which deals directly with taxation, but also on other articles of the Constitution, containing some other principles, of a more general nature. So far, the cases decided did not deal with the taxes that form the backbone of the tax system. As it was said, some articles of a more important tax (income tax) come to the fore; it remains to be seen, whether the other key taxes (such as the value added tax, or profit tax) will follow the suit. Be that as it may, however, it seems that in the tax matters the constitutional limitations on taxation are at least gaining on importance, becoming, that way, a caveat for the tax authorities and a potentially strong instrument of control and action in taxpayers' hands. This is especially important, at least in Croatia, when it comes to taxation. This is a complicated and highly specialized area, in which the key changes often pass without being even noticed, let alone commented, by general public. However, although those characteristics could lead to somewhat pessimistic conclusions on the possibility to act, specialist attention, armed with the possibility of lodging the Constitutional lawsuit, could, by all means, make the difference. That should be even

\(^8\) Those five are the ones known to the author at the time of the writing this paper.
more emphasized, bearing in mind some peculiarities of the Croatian tax system, indicating the circumvention, by the tax authorities, of the standard legal procedures. By this, I mean especially the so-called "opinions of the Ministry of Finance". They deal with the tax issues and are regularly issued by the Ministry of Finance, although they have been written by the experts of the Tax Administration.9 Their role is to be the instrument of simplifying, by circumventing, otherwise complicated and potentially politically uncertain parliamentary way of changing and amending tax statutes. The impatience of the Tax Administration is understandable. Its employees face certain issues of practical nature; they recognize that they cannot solve them by applying the regulations in force; so they, following the line of the least resistance, reach for the most "user-friendly" devices, and those are the said opinions.

Originally, those opinions, according to the Act on Tax Administration10 provisions according to which "giving instructions, explanations and opinions on the implementation of regulations in the field of tax" and other budget revenue falls within the competence of the Tax Administration Central Office11. Opinions are by all means the product of the Croatian tax system reform, that started at the beginning of 1994. That reform opened up a number of practical questions concerning particular cases, answers to which were impossible, or only partially possible, to find in the existing regulations. The need arose for additional solutions for individual cases to make possible and reinforce the operation of the new system. The instrument to provide such solutions was found in opinions of the Ministry of Finance. In time, these opinions developed into a specific source of law. Knowing these opinions has gradually become equal to knowing the essential landmarks in the activities and operations of both the tax administrative bodies and of taxpayers. Questions soon arose concerning this practice.

"Does the authority of the Central Office to give "instructions, explanations and opinions", also mean authority to influence and direct, by issuing such opinions, taxpayers' conduct relating to taxes? Or should this only occur through instruments (just internal acts of the highest administrative body within the Tax Administration) to make sure that the requirement of the Central Office authority "to ensure and guarantee uniform implementation of the law and

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9 Tax Administration, headed by director, is, according to present Croatian legal order, "independent administrative organization" within the Ministry of Finance, authorized to assess and collect taxes.
10 "Narodne novine" Nos. 67/01, 70A/01, 94/01, 117/04.
11 The structure of the Croatian Tax Administration follows the territorial organisation of the country. The local offices of the regional office form the first level, regional offices form the second level, and the Central Office is at the top of the structure.
regulations in the field of tax, charges and other budget revenue"12 is realised? If the latter, opinions should only be acts of internal communication of the Central Office to its subordinate bodies by which the Central Office orders these bodies how to act in particular situations. It would ensure uniform implementation of regulation throughout Croatia, while guaranteeing the principle of legality. The fact that the right to authenticate the opinions is the responsibility of the Central Office, which is the highest taxation co-ordination body (and not of the Tax Administration, Ministry of Finance or its head), seems to support this view.

Over time, however, taxpayers have come to regard the opinions as a potential source of law which, as well as solving particular problems at hand, also conveyed a message about how the taxation bodies will act in the same or similar situations. This has meant that, rather suddenly, an additional source of taxation law came into being, which was not provided for by the present legal system. However, opinions as a source of law are rather unreliable because the taxation bodies have no legal obligation to follow them. Furthermore, the opinions do not have to be published officially in the way other regulations must be in the official gazette of the Republic of Croatia, which makes knowledge of them rather difficult to obtain."13

Since the Ministry's opinions are established as an (informal) source of law, something that taxpayers have to count on when planning and conducting their private and business activities, the question arose – is it possible to challenge them through some legal means, i.e. remedy? The answer, for the time being, is negative – at the moment, there is no such instrument at hand. That is especially not the Constitutional lawsuit, because it could be lodged only if the claimant considers some regulation of general nature to be contrary to the Constitution. However, to my opinion, this should be changed. Ministry's opinions, namely, have got such a potential to influence the individual's of legal person's tax situation, making, that way, the person's overall legal position uncertain, that the way has to be found to subject those opinions to efficient legal control, or to define them as advance (letter) rulings, known is some tax systems, with clear legal status. Be that as it may, the analysis of their today place and role within the tax system leads to the conclusion that they undermine the rule of law (i.e. the principle of legality). It is worth mentioning that, to the officials of the Tax Administration, opinions definitely serve as a relevant source of law, the one that even gained it own "legal life", creating a de facto niche in which different opinions contradict one to

12 Act on Tax Administration, Art 6.
another. This causes doubts at the Tax Administration employees, which do not know which of the mutually contradictory opinions they should apply to a case they are resolving.14 Almost needless to say, the whole situation is blatantly non-constitutional.

Having double nature (formally, Ministry's inner acts, actually, regulations of even general nature, published and closely observed by informed taxpayers), they are the cause of legal uncertainty; moreover, they breach one of the basic Constitutional principles, that of legality, stipulating that "laws shall conform with the Constitution, and other rules and regulations shall conform with the Constitution and law" (Article 5 Para 1 of the Constitution). Since the opinions are in fact of unknown legal nature, the legal system is not equipped to deal with them, i.e. to resolve the problems potentially arising from their existence and application; they are simply not foreseen as a kind of regulations. That is where the Constitutional Court could, on the occasion of some future Constitutional lawsuit, fulfill its mission in the area of taxation; it could clear their status, thus assuring higher level of legal certainty of the tax system.

5. STABILISATION AND ASSOCIATION AGREEMENT: NEW PLAYER AT CROATIAN LEGAL SCENE

5.1. NOTION AND NATURE

When considering the instruments of supranational limitation of a state's power to tax in Croatia, it is necessary to deal with the second, and by all means as important as new, layer of the provisions regulating that power. That is the SAA. Basically, SAAs are international agreements, concluded between EC countries and non-EU member states. The legal basis for the conclusion of SAAs in the acquis communautaire is the Article 310 of the Treaty establishing the European Community (hereinafter: EC Treaty), stipulating that "(T)he Community may conclude with one or more States or international organisations agreements establishing an association involving reciprocal rights and obligations, common action and special procedure.". This norm indicates certain links with countries with which SAAs are

14 This type of situations was explained in detail during an M.A. exam at the Faculty of Law, University in Zagreb, in January 2009. The candidate was the employee of the Tax Administration, working as the tax inspector, and thus very well acquainted with the Tax Administration practice, in general, as well in the case of the opinions application.
concluded; that is clear from the ECJ ruling in Demirel case\textsuperscript{15}, according to which SAA is an agreement that creates "special, privileged links with a non-member country which must, at least to a certain extent, take part in the community system". This ruling, thus, expresses the obligation for a non-member state to participate in the community system; SAA could be, therefore, construed as kind of preparatory legal instrument for the full EU membership. Some authors even claim that "the basic aim of an SAA is the preparation of the country concluding an SAA for the full EU membership, and especially for integration to the common market"\textsuperscript{16}, which can be construed as though the SAAs were pre-accession legal instruments from the very beginning.

The Republic of Croatia and the European Communities and their member states concluded the SAA on October 29, 2001; in Croatia, the SAA entered into force on February 1, 2005, upon ratification in all states being contracting parties.\textsuperscript{17} However, SAA is not, by itself, guarantee for the future EU membership. Assertion that SAAs, at the time of their conclusion, were not meant to be pre-accession legal instruments is therefore well founded. Only their later application and the broader political developments led to the change of their interpretation, and, by that, to the change of their nature.\textsuperscript{18} Namely, as Goldner Lang argues in the second chapter of her work, at the time of the conclusion of the first SAAs with Croatia and Macedonia (both SAAs were concluded in 2001), in spite of some different views, SAAs were still not the pre-accession legal instruments. Only later did they evolve to that status. In the course of that evolution, the most important EU policy step towards the countries of the region (West Balkans) was made at the summit in Thessalonica, held in June 2003; "the Declaration from that summit acknowledged that 'the future of the Balkans is within European Union'".\textsuperscript{19} This means that SAAs today could be deemed to be pre-accession legal instruments; such their status was clear prior to conclusion of the SAA with Albania, on June 12, 2006, and it is founded on the clear policy conditions which have to be fulfilled to ensure the countries concluding an SAA with EC countries the status of the candidate country. Those

\textsuperscript{15} Case 12/86, Demirel v Stadt Schwäbisch Gmünd [1987] ECR 3719, Para. 9.
\textsuperscript{16} Brnčić, Ana, Sporazumi o pridruživanju i njihove institucije, in: Izvještavanje elektroničkih medija o EU i Hrvatskoj u procesu pristupanja, Collection of Papers, Media servis, Zagreb, 2005, p 161, and, consenting, Krčelić, Dinka, Sporazum o stabilizaciji i pridruživanju, in: id, p 252; dissenting, however: Goldner Lang, Iris, Sloboda kretanja ljudi u EU, Školska knjiga, Zagreb, 2007, p. 37..
\textsuperscript{17} In Croatia, the Act on ratification of SAA was published in "Narodne novine, Međunarodni ugovori", No. 14/2001 ("Međunarodni ugovori", engl: "International agreements", is the supplement to "Narodne novine", containing international agreements Croatia agreed upon).
\textsuperscript{18} Goldner Lang, p. 20.
\textsuperscript{19} Id, pp. 37,38
conditions are 1. establishing the regional cooperation, 2. fulfilling the rest of the full EU membership conditions, and, 3. EU’s readiness for further enlargement (overcoming EU's "enlargement fatigue").

5.2. TAX PROVISIONS IN STABILISATION AND ASSOCIATION AGREEMENT

Tax (and customs) provisions in SAA Croatia concluded are aimed at prohibition or limitation to a certain extent of discrimination of individuals, as well as legal persons. Thus, under Title IV (Free movement of goods), standstill clause in Article 33, Para 1, stipulates that "(F)rom the date of entry into force of this Agreement, no new customs duties on imports or exports or charges having equivalent effect shall be introduced, nor shall those already applied be increased, in trade between the Community and Croatia.". SAA, in subsequent articles, tackles the problem of fiscal discrimination: Article 34 (titled: Prohibition of fiscal discrimination), in Para 1, stipulates that "(T)he Parties shall refrain from, and abolish where existing, any measure or practice of an internal fiscal nature establishing, whether directly or indirectly, discrimination between the products of one Party and like products originating in the territory of the other Party", and in Para. 2, "(P)roducts exported to the territory of one of the Parties may not benefit from repayment of internal indirect taxation in excess of the amount of indirect taxation imposed on them". Article 35 deals with customs duties which may appear in fiscal disguise; it orders that the provisions concerning the abolition of customs duties on imports shall also apply to customs duties of a fiscal nature.

Since, "(G)iven the origins of the EC a free trade area, the first most important Treaty Freedom was the free circulation of goods", it is not unusual that special attention has been paid exactly to it in the SAAs too. SAA with Croatia is not an exemption. Croatian economy is small and open one, and, being significantly weaker than the economies of EU countries, it is extremely exposed to massive import. Such import is, in fact, exactly what is going on for years, being spurred not only by high demand for imported goods, but, as well, by highly overrated exchange course of the domestic currency to Euro. As such, Croatian economy

20 Id, pp. 38, 39.
21 Customs duties have been mentioned here (and passim in this paper) regarding their basically tax nature (as an indirect tax levied at the moment of import of goods).
would by nature try to protect domestic producers from import, employing different measures from the customs duties arsenal (notwithstanding the name of the measure). When intention to join the EU became the high priority of Croatian overall policy, that protective approach had to be abandoned; supranational taxation limitations, by way of the SAA provisions, came into force and Croatian legislators now have to take into account one more set of restrictions.

But the limitations on national taxing powers are not confined only to the articles mentioned *supra*; rather, there are some more of them, but of a more general nature. Thus, under Title X (Institutional, general and final provisions), Article 119 Para. 1 forbids discriminatory procedures to be applied on a general level for both contracting parties, however, without prejudice to any special provisions contained in the SAA. Both Croatia and the Community are to restrain from any discrimination of contracting parties (that being Croatia and Member States of the EC), their nationals, companies or firms. Para. 2 refers directly to taxation and stipulates that the provisions of Para. 1 shall be without prejudice to the right of the parties to apply the relevant provisions of their fiscal legislation to taxpayers who are not in identical situations as regards their place of residence. By that, the principle of residence has been taken into account as the key principle when the scope of taxation is to be determined. This proviso empowers the contracting parties to subject taxpayers that have no residence at the territory of them to a different tax treatment. It follows, *a contrario*, that those who do have residence on the said territories are to be treated equally.23 So far, there has been one statutory provision of discriminatory treatment of non-residents in Croatia, concerning their income tax allowances:

"The Croatian Income Tax Act stipulates the right for non-residents to deduct the so-called basic personal allowance, i.e. the personal allowance granted to the non-resident taxpayer because of his existence as the taxpayer, from the taxable income. However, non-residents cannot deduct the rest of the personal allowance (the part based on the existence of his dependent family members); this deduction is explicitly limited to resident taxpayers. To described extent, Croatian income tax system currently violates some Court rulings that have concerned this matter, for example Asscher and Gerritse cases, if not Schumacker, more permissive to the source states."24

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23 The issue of different tax treatment will also be discussed in the part of this paper that deals with Croatian double taxation conventions.

In articles 89 and 90, under Title VIII (Cooperation policies), cooperation policy in the fields of customs and taxation has been regulated. Cooperation in the sense of Article 89 Para. 1 should "guarantee compliance with all the provisions scheduled for adoption in the area of trade and to achieve the approximation of the customs system of Croatia to that of the Community, thus helping to pave the way for liberalisation measures" planned under the SAA. Para. 2 stipulates the forms of cooperation in a more specific way. As can be seen, Article 89 aims at adjusting the Croatian customs system to the one of Community, confirming (in that part) the pre-accession nature of the SAA. As for taxation, pursuant to Article 90 SAA, the contracting parties "will establish cooperation in the field of taxation including measures aiming at the further reform of the fiscal system and the restructuring of tax administration with a view to ensuring effectiveness of tax collection and the fight against fiscal fraud". Although it is not explicitly mentioned, it could be concluded that this norm aims primarily at Croatia. Generally, one could argue that every fiscal system is at any given time suitable for reform, and every tax administration for restructuring – after all, there is always room to improve, especially in the field of public administration. However, bearing in mind the need for Croatian legal system to adjust to _acquis communautaire_, and the word "association" in the title of the agreement, the said conclusion seems to be well grounded. This is even clearer from the Article 69, Para. 1, according to which parties "recognise the importance of the approximation of Croatia's existing legislation to that of the Community. Croatia shall endeavour to ensure that its existing laws and future legislation will be gradually made compatible with the Community (acquis)".

Measures mentioned are not defined by SAA – but it should not be expected in an international agreement of such a general nature. More specific international agreements, like, for example, double taxation conventions are without a doubt more suitable for this.

6. STABILISATION AND ASSOCIATION AGREEMENT AND EU LAW – LEGAL STATUS IN CROATIA

6.1. STABILISATION AND ASSOCIATION AGREEMENT

Legal status of the SAA is rather new legal issue in the legal system of the Croatia as an applicant state, though it could not be said that there is no legal guidance for the definition of
that status. SAA is an international treaty, and Croatian Constitution regulates the status of such legal documents; Article 140 explicitly stipulates a monistic approach, meaning that international treaties are, by their legal force, above the laws of the Croatia, and that they constitute the part of the internal Croatian legal order. This can be construed as though they can be directly applied (i.e. they have direct effect\(^{25}\)) by, for example, the Croatian courts. However, in the Croatian legal literature, certain skepticism has been expressed, regarding such direct effect. It had been pointed out that provision on the direct effect of the international treaties lacks in the Croatian Constitution, and that no "constitutional revolution", in the Joseph Weiler's sense, had happened in Croatia, thus resulting in the rigidity of the legal system when it comes to direct application of the international treaties.\(^{26}\)

According to the current situation, therefore, by force of the constitutional rule, the international agreements are above domestic laws, but such a superior legal position has little (or not at all) practical implications, since Croatian courts are highly reluctant to apply provisions of those agreements. However, the domestic courts are not the only subjects to be asked on the issue, i.e., there are different views, expressed by a number of subjects. For example, it is settled ECJ case law that "in conformity with the principles of public international law community institutions which have power to negotiate and conclude an agreement with a non-member country are free to agree with that country what effect the provisions of the agreement are to have in the internal legal order of the contracting parties\(^{27}\), and further: " Only if that question has not been settled by the agreement **does it fall for decision by the courts** having jurisdiction in the matter"(bold: H.A.)\(^{28}\). In an other case, the Court held that "(A) provision in an agreement concluded by the community with non-member countries must be regarded as being directly applicable when, regard being had to its **wording and the purpose and nature** of the agreement itself, the provision contains a clear and precise obligation which is not subject, in its implementation or effects, to the adoption of any subsequent measure" (bold: H.A.).\(^{29}\) Determinants "Wording", "purpose" and "nature" have by an author been described as "additional political requests" that have to be fulfilled for

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\(^{27}\) Case 104/81, Hauptzollamt Mainz v C.A. Kupferberg & Cie KG a.A. [1982] ECR 3641, Para 17..

\(^{28}\) Id.

direct applicability of international agreement to be possible.  

"Having established the general rule, according to which the norms of (...) SAAs have got direct effect if they contain a clear and precise obligation, and their direct effect conforms with the purpose and nature of the SAA", it remains to point out the fiscally important provisions, and SAA does contain some of that kind. The prohibition of fiscal discrimination, concerning imported goods, is contained in the Articles 34 and 35 of the SAA. Pursuant to the Article 34, Para. 1: "The Parties shall refrain from, and abolish where existing, any measure or practice of an internal fiscal nature establishing, whether directly or indirectly, discrimination between the products of one Party and like products originating in the territory of the other Party." At the same time, the export subsidy is prohibited, pursuant to Para. 2: "Products exported to the territory of one of the Parties may not benefit from repayment of internal indirect taxation in excess of the amount of indirect taxation imposed on them.". Pursuant to Article 35, hidden customs duties are prohibited: "The provisions concerning the abolition of customs duties on imports shall also apply to customs duties of a fiscal nature.".

6.2. EU LAW

The Republic of Croatia and EU initiated what seems to be irreversible process which should end in full Croatian EU membership. Although seemingly far from being finished, that process raised some questions that some members of the Croatian legal community feel compelled at least to try to answer. However, it should be noted that they are mostly scholars – from the point of view of the practitioners, those questions are still far from being urgent to respond. One of them is – the question of interpretative effect of European law in the legal order of the Croatia as a candidate country. More precisely, the question is – could Croatian courts, when interpreting law, take into consideration EU law. Euro-optimists in Croatian legal community are without doubt in favor of positive answer. When arguing their case, they emphasize that, constitutionally, Croatian courts are autonomous and independent when performing their duty, and that they are obliged to judge based on the Constitution and laws.

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30 Goldner Lang, p 40.
31 Id.
32 This is going to be a bumpy road, though; process of adjusting the Croatian legal system to acquis communautaire is, by itself, "the long and winding road", let alone the obstacles created by some Member States, induced, in their actions, by some unsolved bilateral issues.
33 See: Capeta, Tamara, Interpretativni učinak europskog prava u članstvu i prije članstva u EU, Zbornik Pravnog fakulteta u Zagrebu, Vol. 56, No. 5/06.
Since the Constitution contains no ban of the use of EU law as a means of interpretation, there is "no legal obstacle for judges, especially when interpreting the laws enacted as a result of harmonization of Croatian law with European, to take into account the European norms, the Croatian laws had been harmonized with". Opposite could be said too, though – there is no obligation whatsoever for the courts to apply European law, since Croatia is not the Member State (yet). However, there is one strong argument for the application of the *acquis communautaire* even before Croatia joins the EU, and it is exactly the process of harmonization. Croatia has to adopt *acquis* before gaining the status of the Member State; in fact, Croatia is in the middle of that process. Therefore, since Croatia has already adopted considerable part of the *acquis*, and will by all means adopt the rest as well, there is no reason for the courts not to interpret legal issues using EU law. It follows from the SAA, too that "Croatia shall endeavor to ensure that its existing laws and future legislation will be gradually made compatible with the Community (*acquis*)." All this forms a solid ground for Ćapeta to conclude that the idea of interpretation of the law, by Croatian courts, harmonized with the European law should in Croatia be accepted before the country become the Member State, and that there are no legal obstacles to do so.

So far, there are no signs that Croatian courts have even considered this approach, let alone applying it; perhaps "the rigid, narrow and closed dominant Croatian legal culture", very similar to the ones in the other transition countries, has to do something with such non-activity. However, if this approach was accepted, an international agreement (the SAA) would give rise to another supra-constitutional legal instrument to influence Croatian legal order in general, taxation, as part of that order, being, of course, not an exemption.

7. CONVENTIONS FOR AVOIDANCE OF DOUBLE TAXATION

Bilateral conventions for the avoidance of double taxation (hereinafter: tax treaty) Croatia concluded represent another set of sources of law that by definition override national tax statutes, since, as it has been mentioned *supra*, due to monistic approach adopted in Croatia, they take precedence over national law. There is forty six tax treaties currently in force in

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34 Id., p 1479.
35 Article 69 of the SAA.
36 Ćapeta, p. 1492.
37 Id.
Croatian legal system; what makes a general difference (even certain peculiarity) to other tax treaty networks is that some of them (six, to be precise) had been assumed from the legal order of the former SFRY. The Republic of Croatia applies them under approval of the other contracting parties. Generally, in all treaties Croatia concluded as an independent state, it follows the text of the OECD Model of double taxation convention, although there are some exceptions to the rule.

There are some differences between the concept of taxation contained in the articles of the Croatian tax treaties and the one that could be find in the internal Croatian tax law. Interests on bank deposits and dividends, outbound dividends as well, e.g., as has been described supra, pursuant to Croatian Income Tax Act, are not subject to taxation in Croatia, while in tax treaties there is the possibility for the treaty partners to tax those items of income (pursuant to Articles 10 and 11 of all Croatian tax treaties). However, those different solutions legally do not contradict each other, since tax treaties cannot establish new obligations for the residents of the contracting parties; on the contrary, they can only limit taxing powers of those parties. There has been no examples yet of extending taxpayers’ obligations, or introducing new ones, by way of internal Croatian statutes, so, for the time being, it could be concluded that tax treaties, by their nature (as international agreements) generally are a supranational limitation to taxing powers of the Croatian tax authorities, but that so far there was no need to challenge some Croatian inner regulations on the grounds that they are contrary to tax treaties provisions.

38 These treaties, in force in Croatia since 1991, are: Convention between The Kingdom of Denmark and The Socialist Federal Republic of Yugoslavia for the avoidance of double taxation with respect to taxes of income and on capital; Convention between The Republic of Finland and The Socialist Federal Republic of Yugoslavia for the avoidance of double taxation with respect to taxes and on capital; Convention between The Italian Republic and The Socialist Federal Republic of Yugoslavia for the avoidance of double taxation with respect to taxes on income and on capital; Convention between The Kingdom of Norway and the Socialist Federal Republic of Yugoslavia for the avoidance of double taxation with respect to taxes on income and on capital; Convention between The United Kingdom of Great Britain and Northern Ireland and the Socialist Federal Republic of Yugoslavia for the avoidance of double taxation with respect to taxes on income and on capital; Convention between The Kingdom of Sweden and the Socialist Federal Republic of Yugoslavia for the avoidance of double taxation with respect to taxes on income; Convention between the Kingdom of Sweden and the Socialist Federal Republic of Yugoslavia for the avoidance of double taxation with respect to taxes on income and on capital. These agreements were published in the official gazette of the former SFRJ – “Službeni list - međunarodni ugovori” and assumed by the Republic of Croatia - "Narodne novine - Međunarodni ugovori", No. 53, 1991, applicable since 8 October 1991.

39 More detailed overview and analysis of those differences has been presented in: Arbutina, Hrvoje, and Nataša Žunić Kovačević, National Report (Croatia), conference "The History of Double Tax Conventions", Rust, Austria, 3rd to 5th July 2008.
8. CONCLUSION

Constitutional and supranational limitations on the power to tax in Croatia appear at two levels: at the Constitutional level and at the level of international agreements.

Direct Constitutional limitations, embodied in Constitutional provisions regulating taxing powers itself, are scarce. They emphasize the principles of equity and equality – and stop there. Other aspects of taxation are not subject of direct Constitutional provisions. However, some other provisions can easily be applied in matters of taxation, providing that way solid ground to resolve tax cases when those are brought to the Constitutional Court. It had already been proved in the Constitutional Court case law. Constitutional Court controls if the sub-Constitutional regulations are in line with the Constitution; in that sense, it is a sort of watchdog, taking care of the rule of law at the most general level. The number of tax cases brought to the Constitutional Court and decided by it has been, so far, small, but with a growing number of cases still pending. It indicates that the role of the Constitutional Court as a guardian of the taxpayers' constitutional rights will grow bigger in the time to come.

In a broader context of this paper's topic, a specific phenomenon is worth mentioning – so-called opinions of the Ministry of Finance. They are sort of response of the Croatian Tax Administration to the slow and complicated procedure, required for the changing and amending the tax statutes. Using those opinions, Tax Administration circumvents that procedure to resolve some urging questions that arise in everyday taxation practice, creating that way a new and informal source of law. However, no matter how handy and convenient, opinions breach statutory procedures and create considerable legal uncertainty; as such, they should become the object of constitutional (or at least parliamentary) control, resulting, eventually, in their abolition as a relevant source of law in tax matters.

International agreements, Stabilisation and Association Agreement and double taxation conventions (tax treaties), represent set of supranational rules that also limit national taxing powers. By Constitutional provision, those agreements are by their legal force above domestic statutes. SAA is, in this moment, of special importance for the Republic of Croatia. It is the pre-accession legal instrument, representing preparatory legal grounds, if not guarantee, for Croatia's accession to the EU. As such, it contains provisions that regulate non-discrimination or limited discrimination in the field of taxation (limited discrimination being grounded on
residence as broadly accepted principle determining personal scope of taxation). The question of direct effect of SAA before Croatian courts has been raised by scholars working in the field of European public law. They argue that those courts are by all means authorized to directly apply not only the SAA provision, but to use European law as a whole as a means of interpretation when resolving the cases brought before them. This approach is based on the fact that Croatia is in the process of acquiring _acquis communautaire_; European law will relatively soon become the part of the Croatian domestic law, fully applicable by Croatian courts. Therefore, there is no obstacle to start to apply it even before acquiring the full EU membership.

Tax treaties that Croatia applies are mostly concluded by it, but some, dating from the period of the former SFRY, are also still in force. Although they contain some provisions that are in possible discord with some elements of present conception of taxation in Croatia (e.g., taxation of dividends), those provisions do not create the problems in the practice of taxation, since the tax treaties cannot establish new obligations for the residents of the contracting parties. They can only limit their taxing powers; from its side, the Croatian tax system does not contain provisions colliding with those in tax treaties. So far, there have been no issues concerning the application of tax treaties in Croatia.